

This letter discusses Service Occupation Tax and nexus issues related to a company with a subsidiary that has volunteered to collect Illinois sales tax. See 35 ILCS 115/1 et seq. (This is a GIL).

March 5, 2002

Dear Xxxxx:

This letter is in response to your letter dated November 19, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

We are requesting a legal ruling regarding sales and use tax on deliveries into your State.

Our request is on behalf of our client, COMPANY, a printer located in California. They will use this ruling as a basis for sales and use tax compliance in your state.

COMPANY has a subsidiary, (Separate California Corporation/COMPANY B), that will be making sales of printed matter to national customers. The ultimate ownership, corporate management and accounting will be the same for each entity.

Neither COMPANY nor COMPANY B have nexus in Illinois, since all sales, service, etc. for both entities will take place outside your state.

COMPANY B will have contracts with national customers to print and deliver printed matter. Billings may go to one location/state while the actual delivery of the printed matter will be drop shipped into various states, including yours. COMPANY B will subcontract COMPANY to print and drop ship this printed matter. COMPANY will use common carriers to make these drop shipments into the various states. COMPANY will then bill COMPANY B for the printing and freight charges.

Although there may not be a legal requirement to collect and remit use tax in your state, COMPANY B would like to voluntarily obtain a use/sales tax permit and collect and remit the use tax on the shipments into your state.

In closing, we are requesting a written legal ruling for the following:

- 23) Would COMPANY B's registering and filing a use/sales tax return in your State create nexus or a filing requirement for COMPANY?

- 24) Would the fact that COMPANY B's and COMPANY's stockholders and corporate management are the same, require COMPANY to file a use/sales tax return in your State?

If you have any questions, please call me.

We do not have enough information about the operation described to make a formal ruling. However, we hope that the following information regarding Service Occupation Tax, nexus, and nexus created by the activities of an affiliate is useful.

SERVICE OCCUPATION TAX

When a printing company contracts to print custom printed literature, a special order printing situation exists and the transaction is subject to tax under the Service Occupation Tax Act, 35 ILCS 115/1 et seq. Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code Part 140 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen may use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to

the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. De minimis servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. These servicemen are also not liable for Service Occupation Tax.

Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301(a).

When both primary servicemen and secondary servicemen are registered, primary servicemen provide secondary servicemen with a Certificate of Resale. A primary serviceman would then incur Service Occupation Tax based upon the separately stated selling price of the property, 50% of the bill to the service customers or as outlined in method three described above. Upon selling their product, servicemen are required to collect the corresponding Service use Tax from their customers.

Please note that if an unregistered de minimis serviceman subcontracts service work to another unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman. This certification option is only available in multi-service situations when both the primary and secondary servicemen are unregistered and de minimis. If the primary serviceman is registered and the secondary serviceman is unregistered it will not work.

Most printers fall into the fourth category of servicemen described above. That is, as de minimis, unregistered servicemen they may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Such servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Please note, however, that if the servicemen's use of the tangible personal property occurs outside the state of Illinois, out-of-state servicemen who are de minimis and unregistered owe no Use Tax. These servicemen are also not liable for Service Occupation Tax, and, as indicated earlier, their service customers incur no tax liability.

An out-of-State printer who does not have nexus with Illinois, may voluntarily register to collect and remit Service Use Tax, even though he is not required to do so. In this situation, he should use either method one, two, or three above (method three applies only if the serviceman is "de minimis" as explained above) to calculate tax collected from his service customers.

Whether a retailer is subject to Illinois Retailers' Occupation Tax (sales tax) liability or is required to collect Illinois Use Tax from its Illinois customers depends upon whether that retailer will be subject to Illinois law. The following information outlines the principles of nexus.

An "Illinois Retailer" is one that either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set for the guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax law. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Zehnder*, 171 Ill.2d 310 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability, and the customer must remit the amount directly to the State.

In general, the imposition of the various local sales taxes in Illinois takes effect when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115(b), enclosed. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred.

If a purchase order is accepted outside the State, but the property being sold is located in an inventory of the retailer that is located in an Illinois jurisdiction that has imposed a local tax, then the location of the property at the time of sale will determine where the seller is engaged in business for

the purpose of determining the imposition of applicable local sales taxes. In situations in which the retailer has nexus, but both the purchase order acceptance and the location of the property being purchased are outside of the State of Illinois, such sales would only be subject to the Illinois Use Tax at the rate of 6.25%

Generally, when the Department makes determinations regarding nexus through affiliation with another business, the Department considers many factors. These factors include whether the business in question has any physical presence in Illinois. This can include employees, representatives, independent contractors, or agents operating in Illinois under its authority. It can also include maintaining a sales office, retail store, or any other real or personal property in the State. The Department also looks at other factors, including but not limited to, whether the affiliated business that is present in the State serves as a representative or agent for the business in question and whether or not all transactions between the business in question and the affiliated business are conducted on an "arm's length basis." The fact that an affiliated business has volunteered to collect Illinois sales tax, although it does not otherwise have nexus in Illinois, does not create nexus in Illinois for its affiliate.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

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Enc.